

Message Text

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ACTION ARA-17

INFO OCT-01 ADP-00 AID-20 EB-11 NSC-10 RSC-01 CIEP-02

TRSE-00 SS-15 STR-08 OMB-01 CEA-02 CIAE-00 COME-00

FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06 SIL-01

L-03 H-02 PA-03 PRS-01 USIA-12 EUR-25 IGA-02 RSR-01

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R 152000 Z JUN 73

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 8210

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

AMCONSUL RECIFE

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E. O. 11652: N/ A

TAGS: EFIN BR

SUBJECT: CENTRAL BANK ANNOUNCES SUBSTANTIAL MODIFICATIONS
IN RULES FOR FOREIGN FINANCIAL LOANS TO BRAZIL

REF: BRASILIA 4183, 4287 (1972) 2456 (1973)

SUMMARY:

1. AS A RESULT OF ACTION BY NATIONAL MONETARY COUNCIL ON JUNE 12, FOREIGN FINANCIAL CREDITS TO BRAZIL WILL NO LONGER BE SUBJECT TO 25 PERCENT, NO INTEREST, DEPOSIT REQUIREMENT AND MINIMUM TERM INCREASED FROM 6 TO 8 YEARS. BRAZIL WILL NO LONGER ACCEPT SHORT TERM FINANCIAL CREDITS AND REMAINING \$600 MILLION CURRENTLY ON BOOKS WILL BE PAID OFF DURING COURSE OF 1973.

2. COMMENT: ACCORDING TO CENTRAL BANK OFFICIAL, BRAZIL'S INTERNATIONAL MONETARY RESERVES HAVE NOW REACHED \$5.5 BILLION.

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MONETARY AUTHORITIES EVIDENTLY DECIDED IN LIGHT OF CONTINUED STRONG INFLOW FOREIGN CAPITAL, MINIMUM ACCEPTABLE TERM FOR FINANCIAL CREDITS COULD SAFELY BE EXTENDED TO EIGHT YEARS. THIS TOGETHER WITH ELIMINATION OF SHORT TERM

CREDITS WILL SUBSTANTIALLY IMPROVE MATURITY STRUCTURE BRAZIL' S FOREIGN DEBT. CENTRAL BANK OFFICIAL STATED THAT IT IMPOSSIBLE TO TELL NET EFFECT OF REMOVING DEPOSIT REQUIREMENT AND LENGTHENING MINIMUM TERM. STATED THAT AUTHORITIES DID NOT NECESSARILY DESIRE TO REDUCE CURRENT VOLUME OF NET INFLOW FOREIGN CAPITAL. THIS SUGGESTS AUTHORITIES ARE CONFIDENT THEY CAN HANDLE DOMESTIC INFLATIONARY EFFECTS OF CONVERSION CONTINUING HEAVY FOREIGN EXCHANGE INFLOW INTO CRUZEIRO FINANCING WITHOUT JEOPARDIZING ACCOMPLISHMENT OF GOVERNMENT' S 12 PERCENT INFLATION TARGET, AND THAT THEY DESIRE TO CONTINUE TO INCREASE BRAZIL' S FOREIGN EXCHANGE RESERVES. END OF SUMMARY

3. AS RESULT OF NATIONAL MONETARY COUNCIL ACTION AT ITS MEETING ON JUNE 12, THE CENTRAL BANK HAS ANNOUNCED SUBSTANTIAL MODIFICATIONS IN RULES FOR FOREIGN FINANCIAL LOANS TO BRAZIL. A TWENTY- FIVE PERCENT DEPOSIT REQUIREMENT FOR CRUZEIRO PROCEEDS OF FOREIGN FINANCIAL LOANS HAS BEEN ABOLISHED. DEPOSITS HELD IN THE CENTRAL BANK AS RESULT OF LOANS NEGOTIATED SINCE DEPOSIT REQUIREMENT WAS INSTITUTED, WILL BE RETURNED BY CENTRAL BANK IN MONTHLY INSTALLMENTS WITHIN 180 DAY PERIOD AS ENVISIONED IN ORIGINAL REGULATION. EARLIER DEPOSITS WILL BE LIBERATED FIRST. FOR EXAMPLE, DEPOSITS MADE IN OCTOBER AND NOVEMBER 1972 WILL BE RELEASED BETWEEN THE 2 ND AND 6 TH OF JULY 1973, ETC.

B. MINIMUM TERM FOR FOREIGN FINANCIAL CREDITS RAISED FROM 6 TO 8 YEARS. NO GRACE PERIOD IS REQUIRED AND FIRST REPAYMENT ON LOANS MAY BE MADE AFTER SIX MONTHS. THESE LATTER PROVISIONS REPRESENT NO CHANGE FROM SITUATION WHICH PREVAILED FROM INSTITUTION OF SIX YEAR REQUIREMENT IN JULY 1972.

C. ALTHOUGH FOREIGN LENDER IS NOW REQUIRED TO COMMIT HIS FUNDS TO BRAZIL FOR NOT LESS THAN EIGHT YEARS, IT IS NOT NECESSARY TO FIND A SINGLE BRAZILIAN BORROWER FOR ENTIRE PERIOD. FUNDS MAY BE LOANED INITIALLY TO A BRAZILIAN BORROWER FOR TERM OF NOT LESS THAN 18 MONTHS. AT END OF THIS TIME, LOAN MAY BE ROLLED OVER FOR ADDITIONAL PERIOD OF 18 MONTHS OR MORE, OR FUNDS PLACED WITH ANOTHER BORROWER. INDIVIDUAL LOAN AGREEMENTS WITHIN OVERALL EIGHT YEAR TERM MAY
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NOT BE LESS THAN 18 MONTHS. SHOULD FOREIGN LENDER BE UNABLE TO FIND ANOTHER CUSTOMER FOR FUNDS RETURNED BY ORIGINAL OR A SUBSEQUENT BORROWER, FUNDS IN QUESTION MUST BE DEPOSITED IN THE CENTRAL BANK WHICH PAYS INTEREST ON THEM AT LONDON INTERBANK RATE. THESE PROVISIONS EXISTED UNDER THE PREVIOUS RULES AND WERE NOT CHANGED.

D. IN PAST, THE CENTRAL BANK PERMITTED FOREIGN LENDER TO RECEIVE ONLY LONDON INTERBANK RATE, AND NOT AGREED SPREAD OVER THAT RATE, WHEN FUNDS WERE NOT BEING LOANED TO BRAZILIAN BORROWING CUSTOMERS. AS PART OF NEW PROGRAM, CENTRAL BANK HAS ALTERED THIS RULING AND FOREIGN LENDING INSTITUTIONS MAY NOW RECEIVE SPREAD AS WELL. THIS SPREAD MAY BE PAID BY

BRAZILIAN INVESTMENT BANK OR COMMERCIAL BANK AUTHORIZED TO OPERATE IN FOREIGN EXCHANGE. IN SUCH CASES, BRAZILIAN FINANCIAL INSTITUTION WILL HAVE HAD SOME CONNECTION WITH ORIGINAL LOAN SUCH AS A FINDER'S FEE OR A GUARANTEE FEE, DESPITE FACT THAT LOAN, UNDER LAW 4131, MADE DIRECTLY FROM FOREIGN LENDING INSTITUTION TO BRAZILIAN NON-FINANCIAL ENTERPRISE. THUS, UNDER CENTRAL BANK HARD LINE PREVIOUSLY IN FORCE, FOREIGN LENDER TOOK RISK OF LOSING PART OF HIS RETURN DURING PERIODS WHEN FUNDS NOT LOANED OUT TO BRAZILIAN ENTERPRISE. NOW, IF FOREIGN LENDER CAN OBTAIN NEXTENTT WITH COOPERATING BRAZILIAN FINANCIAL INSTITUTION, LATTER MAY, IF IT CHOOSES, GUARANTEE TO FOREIGN LENDER FULL AMOUNT OF LONDON INTERBANK RATE PLUS AGREED SPREAD ON FUNDS LOANED.

4. PRESS STORIES QUOTED FINANCE MINISTER DELFIM NETO AS SAYING THAT BY END OF YEAR BRAZIL WILL HAVE COMPLETELY PAID OFF ITS SHORT TERM FINANCIAL CREDITS OF \$600 MILLION STILL OUTSTANDING. WITH REFERENCE TO THIS REPORT, CENTRAL BANK OFFICIAL EXPLAINED THAT BRAZIL HAD NEVER ENTIRELY ABOLISHED ITS ACCEPTANCE OF SHORT TERM (I.E., ONE YEAR OR LESS) FINANCIAL CREDITS. WHAT IT DID WAS TO LIMIT THE TOTAL AMOUNT OUTSTANDINGNS*)**U*T*R****;ADP000 LIMITED OFFICIAL USE

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6. REVISION OF RULES TO PERMIT PAYMENT OF INTEREST SPREAD DURING PERIODS IN WHICH FUNDS ARE NOT LOANED TO BRAZILIAN BORROWERS STATED TO BE DESIGNED TO FACILITATE DIRECT ACCESS OF BRAZILIAN BUSINESS FIRMS TO FOREIGN FUNDS. THIS RELATES TO FOREIGN LOANS MADE DIRECTLY TO BRAZILIAN NON-FINANCIAL ENTERPRISES UNDER LAW 4131, AND NOT SO-CALLED RESOLUTION 63 LOANS IN WHICH FUNDS ARE LOANED INITIALLY TO BRAZILIAN

FINANCIAL INTERMEDIARY AND SUBSEQUENTLY PASSED TO ULTIMATE BORROWER. IN LATTER CASE, BRAZILIAN FINANCIAL INTERMEDIARY COMMITS ITSELF TO PAY LONDON INTERBANK PLUS SPREAD DURING ENTIRE LIFE OF LOAN AND IT BEARS RISK OF LOSS FOR PERIODS WHEN FUNDS ARE LODGED WITH CENTRAL BANK AND EARN ONLY LONDON INTERBANK RATE. UNDER PREVIOUS LAW 4131 REGULATION, FOREIGN LENDER STOOD TO LOSE SPREAD DURING TIME WHEN FUNDS WERE NOT LOANED OUT. NOW FOREIGN LENDER MAY BE ASSURED OF HIS FULL RETURN IF SUITABLE ARRANGEMENTS CAN BE MADE WITH BRAZILIAN INVESTMENT BANK OR COMMERCIAL BANK AUTHORIZED TO DEAL IN FOREIGN EXCHANGE. AS POINTED OUT IN PARA 3 D ABOVE, LIMITED OFFICIAL USE
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LATTER USUALLY ACT AS FINDER OF CLIENT FOR FOREIGN LENDER. PURPOSE OF CHANGE IS TO FACILITATE AND MAKE LESS EXPENSIVE DIRECT ACCESS OF BRAZILIAN FIRMS TO FOREIGN CREDIT. CENTRAL BANK OFFICIAL EXPLAINED THAT THIS IS SIGNIFICANT ONLY WITH RESPECT TO PURELY BRAZILIAN FIRMS, SINCE BRAZILIAN SUBSIDIARIES OF FOREIGN FIRMS DO NOT HAVE PROBLEMS OF ACCESS TO EURO- MONEY MARKET. BY DEALING DIRECT, BRAZILIAN FIRM MAY BE ABLE TO AVOID PASS THROUGH COMMISSIONS INVOLVED IN RESOLUTION 63 OPERATIONS WHICH, IN PAST, RAN AS HIGH AS 4 PERCENT, ALTHOUGH THEY ARE LOWER NOW. SINCE BRAZILIAN FINANCIAL INSTITUTIONS SEEM TO CONTINUE TO HAVE A ROLE TO PLAY IN 4131 TRANSACTIONS THROUGH FINDER'S OR GUARANTOR'S FEE, IT IS NOT CLEAR WHETHER OBJECTIVE OF REDUCING COST OF FOREIGN CREDIT TO BRAZILIAN FIRMS CAN BE ACHIEVED. HOWEVER, CENTRAL BANK OFFICIAL STATED THAT AS PURELY BRAZILIAN FIRMS GROW AND BECOME BETTER KNOWN IN FOREIGN MARKETS, THEY SHOULD HAVE IMPROVED OPPORTUNITIES TO OBTAIN FOREIGN CREDITS ON MORE FAVORABLE TERMS.

7. IT SHOULD BE NOTED THAT REMOVAL OF THE DEPOSIT REQUIREMENT ALSO REDUCES THE COST OF FOREIGN BORROWING TO BRAZILIAN BUSINESS. IT THUS CONTRIBUTES TO A REDUCTION OF BUSINESS COSTS, INCLUDING INTEREST COSTS, WHICH IS ONE OF GOVERNMENT'S OBJECTIVES IN ITS EFFORTS TO REDUCE INFLATION RATE.

8. GRADUAL RELEASE OF DEPOSITS IS DESIGNED TO AVOID UNDUE INFLATIONARY IMPACT ON DOMESTIC ECONOMY WHICH COULD RESULT FROM RELEASE AT ONE TIME OF VERY SUBSTANTIAL CRUZEIRO RESOURCES IMPOUNDED IN CENTRAL BANK.

9. IN ANSWER TO QUESTION CONCERNING REASONS FOR NEW MEASURES, CENTRAL BANK SPOKESMAN INDICATED THAT BRAZIL'S RESERVES HAVE NOW REACHED \$5.5 BILLION. HE STATED THAT IN VIEW OF CONTINUING LARGE INFLOW OF FOREIGN CAPITAL, ADVANTAGE SHOULD BE TAKEN OF THE OPPORTUNITY TO LENGTHEN STILL FURTHER MATURITY STRUCTURE OF BRAZIL'S FOREIGN DEBT, THE 25 PERCENT DEPOSIT REQUIREMENT HAD OBVIOUSLY BEEN INEFFECTUAL IN STEMMING THE FLOW OF FOREIGN FUNDS, AND WAS CONTRIBUTING NOTHING TO LENGTHENING THE MATURITY STRUCTURE OF THE DEBT. REMOVAL

OF THE DEPOSIT REQUIREMENT WILL MAKE FOREIGN FINANCING
CHEAPER THAN IT WAS, AND THUS ACT AS INCENTIVE FOR ADDITIONAL
FOREIGN BORROWING. ON OTHER HAND, INCREASE IN MINIMUM
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ACCEPTABLE TERM OF FOREIGN FINANCIAL LOANS WILL ACT AS
DETERRENT TO FOREIGN LENDERS. IN ANSWER TO QUESTION AS TO
WHICH OF THESE OPPOSING INFLUENCES WILL BE THE STRONGER, ,
CENTRAL BANK OFFICIAL STATED THAT BRAZIL'S MONETARY AUTHORITIES
HAVE NO WAY OF PREDICTING THE OUTCOME WITH ANY ASSURANCE.

10. IN ANSWER TO QUESTION AS TO WHETHER MONETARY AUTHORITIES
DESIRED TO REDUCE RATE OF INFLOW OF FOREIGN CAPITAL, CENTRAL
BANK OFFICIAL INDICATED THAT AUTHORITIES DID NOT DESIRE ANY
CHANGE IN CURRENT VOLUME OF INFLOW. IF, AFTER FURTHER
EXPERIENCE, INFLOW IS JUDGED TO BE EXCESSIVE,
MINIMUM MATURITY
TERM COULD BE FURTHER EXTENDED. ON OTHER HAND, IF FLOW
DIMINISHES TO UNDESIRABLE EXTENT, MINIMUM ACCEPTABLE TERM OF
FOREIGN FINANCIAL CREDITS COULD BE REDUCED. THUS, CENTRAL
BANK MAINTAINS COMPLETE FLEXIBILITY IN THIS RESPECT. IN FACT,
NONE OF OFFICIAL DOCUMENTS ISSUED IN CONNECTION WITH NEW
POLICY, RESOLUTION 259, CIRCULAR 207, AND COMUNICADO 224
CONTAIN ANY REFERENCE WHATSOEVER TO CHANGE TO EIGHT YEAR
TERM. ACCEPTABLE TERM OF CREDITS IS DETERMINED ADMINISTRATIVELY
BY CENTRAL BANK FOREIGN CAPITAL REGISTRAR SECTION (FIRCE),
OF COURSE BY DIRECTION FROM ABOVE. INFORMATION AS TO ACCEPT-
ABLE TERM IS AVAILABLE ONLY FROM BRASILIA, RIO DE JANEIRO AND
SAO PAULO OFFICES OF FIRCE. IN EARLIER PERIOD SEVERAL YEARS
AGO, WHEN CHANGES WERE MADE IN TERMS OF MONTHS RATHER THAN
YEARS, THEY WERE LITERALLY ANNOUNCED BY NOTICES POSTED IN THE
FIRCE OFFICES. MINIMUM ACCEPTABLE TERM COULD BE, AND WAS,,
CHANGED AT END OF ANY BUSINESS DAY. THIS BASIC FLEXIBILITY
IS BEING RETAINED UNDER THE NEW POLICIES JUST ADOPTED.

11. IF, INDEED, MONETARY AUTHORITIES HAVE DECIDED NOT
TO ATTEMPT TO REDUCE CURRENT INFLOW OF FOREIGN FINANCIAL
CREDITS, THIS COULD REPRESENT AN IMPORTANT CHANGE IN
BASIC POLICY. THE DEPOSIT REQUIREMENT WAS INSTITUTED IN OCTOBER
1972, PRINCIPALLY BECAUSE INFLUX OF FOREIGN FINANCIAL CREDITS
CREATED A HUGE VOLUME OF CRUZEIRO COUNTERPART FINANCING. THIS
IN TURN WAS THREATENING TO OVERWHELM THE MEANS OF CONTROLLING
THE MONEY SUPPLY, WITH POTENTIAL DESTRUCTIVE EFFECTS ON THE
FIGHT AGAINST INFLATION. INCREASE OF RESERVES OF \$1.3
BILLION THUS FAR IN 1973, AN ANNUAL RATE OF SOME \$2.6 BILLION,
IS APPROXIMATELY EQUAL TO TOTAL RESULTS IN 1972. HOWEVER, IT
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IS FAIR TO SAY THAT FLOW IN 1973 IS PROBABLY AT SIGNIFICANTLY SLOWER PACE THAN IT WAS IN THIRD QUARTER OF 1972, WHICH FORCED ESTABLISHMENT OF DEPOSIT REQUIREMENTS. IT COULD BE INFERRED THAT BRAZILIAN AUTHORITIES NOW FEEL THAT THEY HAVE THE MEANS, PRESUMABLY WELL ORCHESTRATED OPEN MARKET OPERATIONS, ADEQUATE TO DEAL WITH INFLATIONARY PRESSURES GENERATED BY THE CRUZEIRO COUNTER PART OF FOREIGN FINANCIAL CREDITS. IF THEY ARE SATISFIED ON THIS POINT, AND THEY ARE EVIDENTLY WILLING TO ASSUME THE RISK FOR THE PRESENT THAT CURRENT RATE OF CAPITAL INFLOW WILL NOT JEOPARDIZE ACHIEVEMENT OF 12 PERCENT INFLATION TARGET, THEN THEIR OBJECTIVE IS TO TAKE ADVANTAGE OF PRESENT FOREIGN CAPITAL AVAILABILITIES TO LENGTHEN THE MATURITY STRUCTURE OF BRAZIL'S FOREIGN DEBT. IF PRESENT MEASURES ARE SUCCESSFUL, THE PROSPECT IS THAT SIGNIFICANT PROGRESS CAN BE MADE TOWARD THIS OBJECTIVE BOTH BY THE ELIMINATION OF REMAINING SHORT TERM FINANCIAL CREDITS AND STRETCHING OUT MINIMUM TERM OF NEW CREDITS TO EIGHT YEARS.

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INFO OCT-01 ADP-00 AID-20 EB-11 NSC-10 RSC-01 CIEP-02

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12. IT ALSO MAY BE INFERRED, IF EMBASSY'S UNDERSTANDING THAT AUTHORITIES DO NOT WISH TO DIMINISH CURRENT INFLOW IS CORRECT, THAT AUTHORITIES HAVE DECIDED THAT COST OF CARRYING ADDITIONAL FOREIGN EXCHANGE RESERVES IS JUSTIFIED. WHILE IT IS DIFFICULT TO ESTIMATE APPROXIMATELY COST TO BRAZIL OF ADDING TO ITS RESERVE ACCUMULATION, COST IS BASICALLY SPREAD WHICH MUST BE PAID ABOVE LONDON INTERBANK RATE. IF SPREAD IS ONE TO ONE AND A HALF PERCENT, ANNUAL COST OF CARRYING ADDITIONAL

\$1 BILLION IN RESERVES WOULD BE \$10 OR \$15 BILLION. IT WOULD SEEM THAT, GIVEN THE STAKES INVOLVED IN BRAZIL'S CONTINUING ECONOMIC DEVELOPMENT, THAT AUTHORITIES CONSIDER THIS A RELATIVELY MODEST EXPENSE IN RETURN FOR FLEXIBILITY AND ROOM FOR MANEUVER INCREASED RESERVE HOLDINGS PROVIDE. THEY ALSO HAVE IMPROVED BRAZIL'S CREDIT STANDING AND REDUCED THE COST OF FOREIGN BORROWING.

13. IN CONVERSATION WITH CENTRAL BANK SPOKESMAN, LATTER INDICATED THAT EURO- MONEY MARKET IS ONLY PRACTICAL PRESENT LIMITED OFFICIAL USE
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SOURCE OF FUNDS TO FINANCE BRAZIL'S GAP IN REAL RESOURCES. DISBURSEMENTS OF INTERNATIONAL LENDING AGENCIES AND PROCEEDS OF BILATERAL GOVERNMENTAL LOANS HAVE BECOME RELATIVELY INSIGNIFICANT IN COMPARISON WITH SCALE OF BRAZIL'S USE OF FOREIGN RESOURCES. THUS, BRAZIL, BY ADDING ADDITIONAL RESERVES AND STRETCHING OUT ITS DEBT, IS ATTEMPTING TO ASSURE ITS MAXIMUM ACCESS TO THIS RESOURCE WHICH IT HAS GAINED BY A CAREFUL CHOICE AND IMPLEMENTATION OF FINANCIAL AND ECONOMIC POLICIES. IN ITS OWN EYES BRAZIL HAS EARNED THE RIGHT, BY ITS SKILLFUL DEBT MANAGEMENT, EXPORT EXPANSION, AND OTHER ECONOMIC AND FISCAL POLICIES, TO OBTAIN ON IMPROVING TERMS THE LARGE VOLUME OF FOREIGN RESOURCES WHICH HAVE CONTRIBUTED SO HEAVILY TO ITS ECONOMIC SUCCESS IN THE PAST SEVERAL YEARS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 10 MAY 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 15 JUN 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: willialc
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973BRASIL03748
Document Source: ADS
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: n/a
Film Number: n/a
From: BRASILIA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t19730635/abqceehv.tel
Line Count: 357
Locator: TEXT ON-LINE
Office: ACTION ARA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators:
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: BRASILIA 4183, 4287 (1972) 2456 (1973)
Review Action: RELEASED, APPROVED
Review Authority: willialc
Review Comment: n/a
Review Content Flags:
Review Date: 16 JAN 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <16-Jan-2002 by boyleja>; APPROVED <16-Jan-2002 by willialc>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: <DBA CORRECTED> gwr 980209
Subject: CENTRAL BANK ANNOUNCES SUBSTANTIAL MODIFICATIONS IN RULES FOR FOREIGN FINANCIAL LOANS TO BRAZIL
TAGS: EFIN, BR
To: STATE INFO RIO DE JANEIRO
SAO PAULO
RECIFE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005